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SUBJECT: RUSSIAN AGRICULTURE JOLTED BY FINANCIAL
CRISIS AND ECONOMIC SLOWDOWN

REF A: GAIN RS8078

SENSITIVE BUT UNCLASSIFIED

1. (SUB) SUMMARY. Russia's agriculture sector has begun to feel the impacts of the global economic crisis. With some 40 percent of investments in Russian agriculture financed by loans, many observers believe that as many as 20 percent of Russian agricultural enterprises may go bankrupt by June 2009. Those most vulnerable to the credit crunch are small producers of crops and dairy products. The Ministry of Agriculture has vowed to continue to support priority projects and fund production. However, inflation in foodstuffs, production costs and an expected decline in agricultural imports in 2009 will continue to exert economic pressure on the Russian Ministry of Agriculture, consumers, farmers, and importers. END SUMMARY.

EFFECTS ON PRODUCERS AND IMPORTS

2. (SBU) In the wake of the global financial crisis, Viktor N.Khlystun, Deputy Head of Rosselkhozbank, and the Chairman of the Agribusiness Club, recently stated that the shrinking availability of credit is the main existential threat to the development of Russian agriculture and the Russian food industry. Russian bakers are complaining that they cannot receive short term loans for working capital. Many producer groups have reported that Russian farmers have stopped buying equipment. For instance, Arkadiy Zlochevskiy, the head of Russia's Grain Union, told us on October 24 that wheat farmers have been unable to buy agricultural equipment, because of a lack of credit.

3. (SBU) The crisis has already affected the financial plans of some big agricultural holdings. "Agroholding", one of the biggest poultry producers, after a technical default, declared that the company will freeze 5 billion rubles (\$188 million) worth of investment projects that are less than 90 percent complete. Another agroholding "Razgulay" (grain processing and trade, sugar production and refining, and land ownership businesses) has declared that it will

freeze 5 billion rubles worth of investments in the construction of 5 regional elevators and grain export terminals. Rosselkhozbank has stopped financing new projects. Sberbank has also stopped all loans to agricultural producers, according to the rumors circulating in the Russian agribusiness community.

¶4. (SBU) Importers, who receive one third of all Russian agricultural credits, are also suffering from the financial crisis. Euroservice, a large poultry importer and local poultry producer, declared bankruptcy due to the inability to pay back \$646 million in government subsidized loans. This company held 130,000 MT of the U.S. poultry quota for 2008, but managed to import only 30,000 MT before filing for bankruptcy. Cargill representatives in Moscow recently reported that the majority of their poultry, pork and beef contracts for October, November and December have been canceled due the tight credit market. In contrast, both Tysons and Smithfield report that business continues as usual, although they are concerned about the impact that the financial crisis may have on their 2009 sales to Russia.

MINISTRY OF AGRICULTURE'S REACTION

¶5. (SBU) Russian politicians recognize that the disruption in the supply of agricultural or food

products will have a dramatic effect on the economic and social stability of the country. In efforts to restore confidence, on October 18, Agriculture Minister Aleksey Gordeyev took charge of a working group consisting of the six largest banks that finance the agriculture sector. The working group agreed that banks will reduce funding, but priority projects and funds to support production will continue. The group is continuing to identify anti-crisis measures to stabilize the funding of agricultural producers. First Deputy Prime Minister Viktor Zubkov has pledged, "In case of failures, the government will intervene. We have to prevent failures on the foodstuffs market, as any failure means increased consumer demand and tension in society."

¶6. (SBU) Russia intends to continue to subsidize the interest rate that financial institutions charge for agricultural loans. In September, the government issued legislation providing for feed subsidies to swine and poultry breeders. As a result, 10 billion rubles (approximately \$376 million) will be allocated to compensate for the increased costs of feed from the fall 2007 through spring 2008 (Ref A). The government also intends to provide up to 21 billion rubles (\$790 million) for diesel subsidies to farmers. Subsidies for fertilizer have not yet been announced, but have also been promised for this year.

¶7. (SBU) The personal opinion of one Ministry of Economic Development official is that the GOR's stabilization measures, including the Central Bank's injection of liquidity into Russia's banking system, have not yet reached the Russian economy, and the declared funds are lower than what is needed to support Russian banks, and to stimulate the continued financing of short term debts and obligations.

COMMENT

18. (SBU) Despite the recent effects of the financial crisis on agricultural financing in Russia and the recent weakening of the Russian ruble by 5-10% versus the Euro and dollar, we still believe that 2008 will be a record year for U.S. agricultural exports to Russia. Agriculture will likely remain a priority sector for Russia, and the food industry and importers will continued to receive support from the GOR budget to meet the industry's short-term debts and obligations. Still, financial pressures mean that investment in agriculture will be lower in 2009 than in 2008. We believe that the financial crisis and further ruble depreciation will result in inflation and a decline in overall agricultural and food imports in 2009.

BEYRLE